# Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at http://about.jstor.org/participate-jstor/individuals/early-journal-content.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

# THE INSURANCE OF BANK DEPOSITS IN THE WEST. II. (CONCLUSION)

## OKLAHOMA (*Continued*)

### SUMMARY

*Oklahoma* (continued). Failure of Columbia Bank and Trust Co. Payment of depositors begun at once, 330. — Outcome of the liquidation, 332. — Other failures, 334. — How far deposit insurance caused the failure, 336. — How far politics entered, 338. — A serious question: the size of single risks, 340. — Desirability of postponing payment until after liquidation, 341. — Few conversions into national banks, 342. — Conclusion as to Oklahoma, 343. — *Kansas*. Unsuccessful bill of 1898, 344. — Act of 1909, 346. — National banks, not being allowed to participate, form a Guaranty Company, 349. — Legal complications: the constitutionality of the act questioned, 352. — Working of the act thus far, 355. — *Nebraska*. Act of 1909, 356. — Held unconstitutional by Circuit Court, and not in effect pending appeal, 357. — *South Dakota*. Abortive act of 1909, 359. — *Texas*. Act of 1909. Nominal option between guaranty and an indemnity bond, 362. — Other provisions, 363. — Guaranty plan generally followed, 365. — General regulation of banking, 366. — Effects of the act, 366. — *Colorado*. Unique and interesting bill, but no law enacted, 368. — *Missouri*. Attempts at legislation failed, 369.

Deposit Insurance by Private Corporations, 370. — Proposals and possibilities, 371, 372.

General arguments and conclusions, 373. — Chief purposes of deposit insurance, 373–376. — Objections: unnecessary? Failures, tho rare, are bad, 376. — Depositors cannot pick good banks, 377. — Would insurance bring impossible conditions? 378. — Undue liberality in interest on deposits? 379. — Fictitious loans? 380. — Undue expansion? 381. — No surplus accumulated? 382. — Unfair in taxing good banks? 383. — Premiums inadequate? 383. — State-administered *vs.* private insurance, 386. — The immediate future and the ultimate possibilities, 388.

The compulsory insurance of deposits in Oklahoma state banks began in February, 1908. Within a year and a half the state banks had grown marvelously in number and deposits, while the national banks had decreased in number and remained stationary in

deposits. Then the Columbia Bank and Trust Company failed, with the largest deposits in Oklahoma, and this was a state bank.

Only a faint idea can here be given of the recriminations that have ensued. The national banks have been unfairly charged with having allowed the Columbia Bank and Trust Company to fail when they might have saved it, and with gloating over the failure afterward. On the other hand, opponents of the deposit insurance system have accused state officials of indiscreet relations with the Columbia Bank and Trust Company, have accused the State Banking Board of favoritism in the liquidation, and Governor Haskell with preventing investigation of the causes of failure.[1] Republicans have bitterly assailed the Democratic state administration over the failure and liquidation, and the administration has fervidly answered. The Governor and the Attorney General have quarreled. Litigation has been instituted by some depositors and surety companies. Just what caused the failure has not been told, but the course of events, in so far as they bear upon deposit insurance, is now reasonably clear.

The Columbia Bank and Trust Company was organized in 1905, and its career for several years was uneventful. In October, 1908, control was obtained by W. L. Norton. Mr. Norton had been an active investor in the gas and oil field of eastern Oklahoma and was supposed to be a wealthy man. Besides his oil and gas investments, and the Columbia Bank and Trust Company, he was heavily interested in many other Oklahoma banks, both state and national.

The capital of the Columbia Bank and Trust Company was $200,000. Its statement of September

[1] For the Governor's explanation see p. 339, *infra*.

23, 1908, showed deposits of $365,000, of which $110,000 was due to banks. The remarkable growth of its deposits thereafter is shown by the following figures: —

| | | |
|---|---|---|
| Deposits, September | 23, 1908 | $365,686.01 |
| " November | 27, 1908 | 602,529.90 |
| " February | 5, 1909 | 1,111,805.64 |
| " April | 28, 1909 | 1,721,039.70 |
| " June | 23, 1909 | 2,345,100.33 |
| " September | 1, 1909 | 2,806,008.61 |

The deposits of September 1, 1909, were classified as

| | |
|---|---|
| Individual deposits | $1,321,929.31 |
| State Treasurer's Deposit | 172,383.13 |
| Bank Deposits | 1,311,696.17 |

In less than a year, therefore, the individual deposits had increased from $255,000 to $1,300,000, and the bank deposits from $110,000 to $1,300,000; a growth astonishing even in Oklahoma.

At this time opinions about Mr. Norton differed widely. Some bankers considered him a successful business man, worth a million dollars. Others regarded him as perhaps successful, but a plunger, and had nothing to do with his banks.

The closing of the bank was imminent some days before it occurred. A large amount of currency was rushed to the other Oklahoma City banks to save the situation if alarm should spread. The Oklahoma City Clearing House banks offered to lend $250,000 or more in cash, if good security could be given them, and if such assistance would save the bank. This offer was declined by the Bank Commissioner, who took charge of the bank on the night of September 28, 1909, and opened the doors next morning to pay off the depositors as provided by the guaranty law.

Several hundred people assembled, but there was no such excitement as would attend the closing of so large a bank whose deposits were not insured. The Commissioner began to pay depositors at once, and announced that all would beyond question be paid in full. This was a good deal to say, as there was at the time only about $400,000 in the guaranty fund, but the fact that payments were actually going on reassured most depositors.

The liabilities to be liquidated September 28, 1909, were: —

| | |
|---|---|
| Individual Deposits | $1,165,747.42 |
| Savings Deposits | 75,061.36 |
| Certificates of Deposit | 353,184.86 |
| Bank Deposits | 1,293,385.73 |
| Cashier's Checks | 10,090.96 |
| Certified Checks | 3,577.60 |
| Total | $2,901,047.93 [1] |

The amount of cash and sight exchange is not given in the Commissioner's statement. On September 1, 1909, it was shown as $1,134,981.95. Whatever it was September 28, it was far too little to pay the depositors, even with the whole of the guaranty fund added. The annual assessment for the fund of one-quarter of one per cent. of deposits had recently been collected.

It will be remembered that, under the Oklahoma law, emergency assessments may be made any year up to two per cent. of deposits. The emergency assessment in this case was, however, fixed at three-quarters of one per cent. of the average deposits of 1908. Under this assessment, the state banks of

[1] Statement of Bank Commissioner Young, October 30, 1909, to State Banking Board; Oklahoma Banker, vol. i, p. 136.

Oklahoma had to pay $248,000.[1] Many state bankers were incensed at the failure and at the relations that were said to have existed between state officials and the bank. There was talk of resisting the assessment, but no banker cared to refuse payment at the risk of having his bank closed. Governor Haskell says, indeed, that only eleven protests were received.[2] That there was discontent is shown by the fact that the Eastern Group of the State Bankers' Section of the Oklahoma Bankers' Association met at Tulsa about a month after the failure of the Columbia Bank and Trust Company, and adopted resolutions urging changes in the guaranty law.[3]

We have seen that the Bank Commissioner, acting for the State Banking Board, began to pay depositors on the morning after taking charge. Yet the resources of the Columbia Bank and Trust Company and of the guaranty fund together were not nearly enough to go around; and he could not possibly have known how much the loss on the loans and investments of the bank would prove to be. Such procedure can be justified only by success, if at all.

It was decided to pay the individual depositors first, but even they could not all be paid at once, and charges of discrimination were inevitable. The small or moderate accounts were, in the main, paid promptly.

[1] Bank Deposit Guarantee Journal, December 1909, p. 35.

[2] The Commoner, Lincoln, Neb., vol. ix, No. 48, p. 2.

[3] The changes proposed were: —

*First:* That the state banking board be abolished and that the management and control of the guaranty fund be placed in the hands of the state bank commissioner.

*Second:* That the guaranty fund be redeposited with the banks from which it originated without interest.

*Third:* That the state bear the expense of maintaining and operating the guaranty fund.

*Fourth:* That upon the liquidation of any bank, this bank shall take over as an asset ninety per cent. of the unused portion of the guaranty fund contributed by it.

The first and fourth changes might be desirable. The others would be mistakes.

The accounts of banks were larger, and only such as could make a showing of need were taken care of at first. No bank seems to have been in jeopardy because of the tie up of its account in the Columbia. Legal proceedings asking that a receiver be appointed to wind up the bank in the old fashioned way were begun in two cases. One case was over a disputed claim, and the United States Court denied the petition for a receiver. The other case was that of a depositor aggrieved by having payment of his large deposit postponed in favor of smaller ones. The deposit was paid, however, and the proceedings were dismissed.

The Bank Commissioner's statement of October 30, 1909, a month after the failure, showed $411,000 of deposits still unpaid, not including the School Land Fund Account, secured by collateral and by surety company bonds, nor $20,000 due to the Treasurer of Oklahoma County. The unpaid deposits of banks were $262,000, while the unpaid individual and savings accounts, certificates of deposit, and miscellaneous items had been reduced to $149,000. This is an extraordinary showing, probably without a parallel. The deposit of the State Treasurer, amounting to $189,000, had been paid by the sale of collateral held to secure it. Other securities owned by the bank had been marketed, collections had been pushed, and $503,000 of the guaranty fund had been used. The total expense of the liquidation had been only $2,400, again a remarkable showing.

Besides the deposits, the bank owed $210,000 which the Bank Commissioner considered not a charge on the guaranty fund, — either public deposits secured by surety company bonds and collateral,[1] or amounts

[1] There is no good ground for the statement that Oklahoma is inconsistent in requiring banks to furnish security other than the guaranty fund to protect deposits

actually paid on behalf of the bank by surety companies liable on such deposits. The District Court at Oklahoma City has since ruled that the Commissioner is wrong, and that these liabilities are a charge on the guaranty fund.

| | |
|---|---|
| To this item of . . . . . . . . . | $210,000.00 |
| Add unpaid deposits . . . . . . . | 411,675.41 |
| Add amount due guaranty fund . . | 503,725.25 |
| And we have the bank's total liabilities October 30, 1908 . . . . . | $1,128,400.66 |

Mr. Norton and others had been induced to turn over to the State Banking Board notes, bonds, real estate, and oil producing properties valued at $563,600. These will have been a most important aid to the liquidation unless the Board shall be compelled to surrender them in bankruptcy proceedings that have been threatened in connection with another failure to be mentioned later. Besides the securities received from Mr. Norton, the Bank Commissioner had on hand October 30, assets of the bank of the nominal value of $1,199,600.63, making total of $1,763,200.63. A shrinkage of over $600,000 could occur, and still leave enough to repay the depositors, repay the guaranty fund, and repay to the banks the emergency assessment they had paid. The Bank Commissioner announced that the assessment would be repaid, and authorized such banks as wished to do so to carry it on their books and in their official statements as an amount "loaned to the state." The repayment of this "loan" depends on many things, and in the

of public funds. Such deposits are large enough to increase unduly, if special security be not required, the amount at the risk of the guaranty fund in single institutions. This is particularly true of the deposit of the guaranty fund itself. It would be unwise to let the fund secure itself. Cf. what is said on this subject in the account of the Texas and Nebraska laws, below, pp. 363, 364.

meantime it is an asset of problematical value. In many cases three-fourths of one per cent. of deposits is three per cent. of capital. To charge off the assessment would have meant to some banks passing the next semi-annual dividend, and would have made the guaranty law decidedly unpopular with their stockholders. While not at this time a vital matter, it would seem that it is a mistake of principle to try to make the assessment palatable by allowing it to be carried as a loan instead of ordering it charged off at once.

The liquidation of the bank proceeded rapidly. On November 13 (1909), the Commissioner said in a letter to the writer that the amount due to banks had been reduced from $1,300,000 at the time of the failure to $190,000. In an address at Sulphur, Oklahoma, on December 6th, the Commissioner said that the bank stilled owed only thirty-nine Oklahoma banks, and that the State Banking Board had then on hand sufficient cash to pay all individual depositors and all holders of Certificates of Deposit. The unpaid Certificates of Deposit amounted to $27,500, and the holders of these had been satisfied with " gilt edge " paper.

Prior to the failure of the Columbia Bank and Trust Company, Mr. Norton was apparently disposing of other banks he controlled. Among these was the Farmers National Bank of Tulsa, of which E. F. Blaise was President. About the middle of December the bank was closed, because, according to Mr. Blaise, of large indebtedness of Mr. Norton to the bank. Mr. Norton, according to press dispatches, denied that he owed the bank individually, and declined to say whether oil companies in which he was interested owed the bank or not.

The First State Bank of Kiefer was under allied management, and having $30,000 on deposit in the Tulsa bank, was carried down by the failure. Its deposits of $78,000 were promptly paid with the use of about $40,000 of the state guaranty fund.

Mr. Blaise asserted that unless Mr. Norton's indebtedness to the Tulsa bank was made good, bankruptcy proceedings would be instituted against Mr. Norton on the theory, doubtless, that in turning over securities to the State Banking Board, Mr. Norton was preferring the Columbia Bank and Trust Company to other creditors in a manner open to attack under the United States bankruptcy law. The Bank Commissioner advised Mr. Blaise not to institute proceedings, and he has not done so. Should he do so successfully, the $563,600 of securities turned over by Mr. Norton would have to be surrendered, and it might be impossible for the Bank Commissioner to reimburse the guaranty fund. Another emergency assessment on the state banks might even be necessary.

Another legal question that may involve the same possibilities has been mentioned above. It was the theory of the Bank Commissioner that public deposits secured by bonds executed by surety companies were excepted from the operation of the guaranty law, and were not insured by the guaranty fund. No such exception appears in the guaranty law; and surety companies that had furnished bonds, covering the deposits by the Land Commissioners' office in the Columbia Bank sought to have the Bank Commissioner restrained from repaying the state guaranty fund until he had paid the Land Commissioners' office its deposits pro rata with payments made to other depositors. Such an order was made by the District Court at Oklahoma City. The principle

involved applies to all public deposits secured by surety bonds, and if the decision is sustained by the Supreme Court, the full repayment of the emergency assessment will probably have to be postponed and perhaps abandoned.

Was the insurance of deposits to blame for the failure of the largest bank in Oklahoma? A national bank, we have seen, was carried down by similar bad management, and it is an open secret that still another national bank, of which Mr. Norton was President for several years, had to be taken over last fall by a new bank, under a new name and charter. Obviously, the Oklahoma insurance plan was not responsible for the misfortunes of these national banks. Yet it cannot be relieved of all responsibility for the Oklahoma City failure. The case was of the sort familiar enough (as New York City can witness) where control of a bank was bought by a man who, whatever his capacity for other business, ought not to have engaged in banking at all. His policies were unwisely liberal. For instance, in a number of cases he offered to receive from large institutions in other cities all their checks on Oklahoma points, enter credit to such institutions at par, and remit at par a week later. Now the exchange charges of Oklahoma country banks are usually considerable, and a week is scarcely more than enough to send checks and receive payment by mail. The Columbia Bank and Trust Company was probably losing money on the proposition; besides inflating its deposit and cash accounts in a way deceptive even to itself.

This is a minor matter, however, in comparison with the loans and overdrafts. The overdrafts when the Bank Commissioner took charge were $200,000. The total losses incurred by the bank have been

estimated by the Bank Commissioner at $400,000, and by the Oklahoma City Times at $800,000.

Now a liberal or reckless bank policy frequently attracts extensive deposits, and the business of the Columbia Bank and Trust Company would have grown a good deal under Norton's management even without deposit insurance. This insurance, however, made the growth faster and larger. Relying upon the insurance, Oklahoma banks, and outside banks too, felt safe in carrying deposit accounts with the Columbia, and in taking advantage of its liberality in collecting country checks at par. Outside of Oklahoma, the bank advertised widely. The writer spent the summer vacation on Lake Ontario, and in the Rochester paper read every Sunday the advertisement of the Columbia Bank and Trust Company for deposits at four per cent., " deposits guaranteed by the law of Oklahoma." Such advertising drew a good deal of outside money into the Columbia. It is evident, then, that just as critics predicted, the insurance of deposits has made it easier for an incompetent management to get deposits. The insurance system is not responsible for the failure of the Columbia Bank and Trust Company, but it is responsible for the magnitude of it.

In theoretical discussions of the subject, it is often suggested that under state-administered insurance of bank deposits, failures will be exceedingly rare; because, it is argued, official supervision will be more strict, and self interest will cause the banks to keep effective watch of each other's business. There is something in these suggestions, but it would not be safe to let them determine a legislative policy. Banks know about some of each other's loans, but by no means about all. If the mutual supervision of bankers

is wanted, it can be exercised effectively only through examiners reporting to a committee of the bankers themselves. Such a system has been adopted of late years in several clearing house cities. Oklahoma City has adopted it since the failure, and one of Commissioner Young's examiners has resigned to become the Oklahoma City Clearing House examiner. It has been proposed to extend the system over whole states, as in itself a safeguard to depositors. The mutual watchfulness of bankers did not save the Columbia Bank and Trust Company, nor was state supervision under the insurance plan strict enough to save it. The bank had, indeed, been examined, the Commissioner says, by two of his best deputies only about sixty days before the failure, and had been found in good condition.[1] Governor Haskell believes that the principal losses occurred within one month of the closing of the bank. This proves, if proof be needed, that no supervision can prevent the failure of bankers so unfortunate or imprudent as to make a quantity of bad investments in a short time.

It is alleged that the Columbia Bank and Trust Company was in politics, and that for this the insurance plan is to blame. The State Treasurer, James Menefee, held $25,000 of the capital stock. In buying stock, Mr. Menefee gave three notes of $10,000 each to the seller, who turned over at least two of them to the Columbia Bank and Trust Company. They were in the bank at the time of the failure, neither being due. One has since been paid. The State Treasurer, a stockholder, and in this manner a debtor of the bank, had on deposit there when it failed, $189,000, and as Treasurer of the State Banking Board, $76,000 more, secured as stated above.

[1] Oklahoma Banker, vol. i, p. 166.

An appointive state officer is said to have owed the Columbia Bank and Trust Company about $6,000 to within a few days of the failure, when he learned of the bank's trouble and paid up. The Oklahoma City *Times* charged that Mr. Norton gave another banker $5,000 to " square things " with the banking authorities. The paper admitted that " things " were not " squared," and that the attorney for the State Banking Board made the banker turn the money into the assets of the bank. All this makes a bad mess, but there have been pet banks here and there since Andrew Jackson's time. Perhaps the Oklahoma state administration was glad to further what seemed to be a conspicuous example of the successful growth of banks under the guaranty law, and perhaps state officials got personal favors of the bank; but to blame the state guaranty system for these personal entanglements is too far fetched. At any rate, the political objection is not fundamental. There is no reason why politics cannot be as completely eliminated from the banking department of a state that insures deposits as from the same department in a state that does not.

The Attorney General recently began a grand jury investigation of the failure, and the Governor stopped him. The Governor was charged with playing politics again, and with stopping the proceedings to save somebody connected with the state administration. His answer was that such an investigation would interfere with the liquidation of the bank, that he wanted to collect what he could for the bank first, and let the grand jury investigate the failure afterwards. This seems reasonable.

The Oklahoma experiment raises another question as to the practicability of state insurance of deposits,

far more serious than the question of politics, more serious even than the stimulus to recklessly managed banks. This is the question of the size of single risks.

On June 23, 1909, the total deposits in Oklahoma state banks were about $47,000,000. The deposits of the Columbia Bank and Trust Company at the time of failure were about $3,000,000, or six per cent. of the total amount at risk. What would happen to a fire insurance company that ran its business so? There is, of course, usually more salvage after a great bank failure than after a great fire, but it takes time to realize on the salvage. The Oklahoma experiment has shown that altho depositors in failed banks may be paid rapidly if the authorities can exercise discretion as to whom to pay, payment immediately upon a failure cannot be promised.

It took only one failure to show this, and another great failure might have broken the Oklahoma system down. What would have happened if another large bank had failed soon after the Columbia Bank and Trust Company, and if its President had not been able to turn over valuable securities? Another assessment would have been necessary to pay depositors immediately, as provided by law. Would the banks, already smarting under an assessment that absorbed a dividend, have paid another assessment without a fight? Probably not. If they had been forced to pay, would not sympathy for the banks have led to the repeal of the law? Probably it would. The Oklahoma plan cannot be a success until a guaranty fund has become very large. Until then, the plan is not insurance, because there is no proper distribution of risks. It is wagering that there will not be enough failures of big institutions to upset the guaranty plan before the necessary reserve has been accumu-

lated. The wager may be successful. Apart from the observed tendency to stimulate improper banking, the statistics of bank failures indicate that it would be successful. There is no certainty about it, however.

Fire insurance companies pay losses only after the amount of salvage has been ascertained or closely estimated. Could a state deposit insurance plan be operated successfully on the same principle? Depositors would probably be satisfied with negotiable certificates, bearing interest while liquidation was going on, just as the notes of Canadian banks draw interest after failure. If the guaranty were good, such certificates would doubtless be purchased or accepted as collateral by other banks.

To some extent the fact that no state-administered deposit insurance scheme can limit the size of risks would jeopardize even a system of payment after liquidation; but such a system would have more chance of success than the scheme of paying as soon as a failure occurs. The salvage in national bank failures averages eighty-two per cent. of the deposits [1] and should be as much in Oklahoma. Perhaps the Oklahoma plan, modified as here suggested, might be a success. Big failures, however, are always possible anywhere, and there would be for many years the possibility of a breakdown, since no state-administered deposit insurance system can limit the size of risks. For the present the success of the Oklahoma plan will be dependent on good luck. It takes seventeen years to accumulate the fund of five per cent. of deposits provided for by the guaranty law, and, in view of the large deposits to be insured in single banks, it is doubtful if even a five per cent. fund would always be adequate to the immediate payment of depositors.

[1] Report of Comptroller of the Currency, 1908, p. 86.

If further heavy losses do not occur for a number of years, the guaranty fund may grow into a sufficient reserve. Until then the plan will be an experiment only. The objection of the size of particular risks is inseparable from state-administered deposit insurance, and can be overcome only by engaging private enterprise in the deposit insurance business.

After the levy of the emergency assessment there was a good deal of talk of the conversion of state banks into national banks to escape future experiences of the kind. The office of the Comptroller of the Currency informs the writer that it is not practicable to announce how many state banks have applied for authority to convert. The Bank Commissioner of Oklahoma says the number is two, and two reorganizations or conversions are all that the writer has noticed in the press dispatches, one at Oklahoma City, and one at Enid, the latter being a reconversion of a state bank that had formerly been a national bank. Five national banks were converted into state institutions between September 1 and November 16, 1909. The state banks continue popular, as would be expected after the apparent success of the insurance plan exhibited in the liquidation of $3,000,000 of deposits. The following table shows that the decrease in the number of national banks and the increase in the number of state banks continue.

| | June 23, 1909 | Sept. 1, 1909 | Nov. 16, 1909 |
|---|---|---|---|
| **State Banks** | | | |
| Number | 631 | 646 | 662 |
| Individual Deposits | $42,722,927 | $44,777,259 | $49,775,433 |
| Total Deposits | 47,147,062 | Not ascertained | 54,963,266 |
| **National Banks** | | | |
| Number | 230 | 225 | 220 |
| Individual deposits | $38,111,948 | $37,726,265 | $41,617,228 |
| Total deposits | 44,450,759 | 43,878,444 | 50,666,687 |

There were early predictions of disaster on account of the organization of small banks in such large numbers, but these banks seem to be getting on. A Western country bank can pay expenses if it can obtain $20,000 of deposits, and in a growing country the future of such a bank is reasonably sure. If some banks have been opened where not required, they will consolidate with others or will liquidate. Their passing will not cause disturbance. Nor has there been any general development of rascality. It may be that here and there is a banker whose antecedents are bad. It is now more difficult than ever for a man of bad record to get into the banking business in Oklahoma. Perhaps there are such in a few Oklahoma banks already; Oklahoma is a new country, and it would be strange if an occasional rascal did not come in. The writer speaks from personal knowledge, however, in stating that Oklahoma bankers, taken by and large, are competent, and men of character.

The failure of one or two banks does not disprove the theory of state-administered deposit insurance, nor does their successful liquidation prove it. The study of the Oklahoma experiment, however, gives us some conclusions of vital importance: —

I. There is need of greater assurance of the safety of deposits than is afforded by mere inspection and supervision. Given assurance which it considers adequate, the public will make greater use of banks, and more banks will be established. We shall consider later how widely this conclusion is valid.

II. The state cannot undertake to pay deposits in full as soon as a bank closes.

III. The insurance of bank deposits assists the growth of bad banks as well as good.

IV. Under a state deposit insurance system the risk that will be assumed on a single bank cannot be limited.

These results will be useful in the consideration of the subject as a whole, after the experiments in other states have been examined.

## Kansas

Oklahoma politics reflect the originality and venturesomeness of the pioneer American, but in the serious consideration of bank deposit guaranty, Oklahoma was long anticipated by Kansas. The writer heard the Governor of Kansas, Major Morrill, a Republican and a banker, say in an address before the Convention of the Kansas Bankers' Association, as early as 1895, that he believed the government should guarantee the deposits in banks; tho in later years Major Morrill opposed the plan. Mr. John W. Breidenthal, Bank Commissioner of Kansas, in the fourth biennial report of his department, September 1, 1898, recommended the enactment of a deposit guaranty law. Mr. Breidenthal, a Populist, was an efficient Commissioner. In the following November, Governor Leedy, also a Populist, was defeated for re-election. In order that deposit guaranty legislation might be had, the Governor called a special session of the legislature, believing that the measure could be put through before the inauguration of his republican successor. The bill provided that banks might either pay to the guaranty fund assessments of one-eighth of one per cent. of their deposits, or place five

per cent. of their deposits with the state treasurer, the income of the five per cent. to go to the guaranty fund. Prominent bankers were at Topeka opposing the bill. It passed the senate, and, after a hot parliamentary struggle in the house, it received the votes of fifty-nine members, a majority of those present, but four short of a constitutional majority. The four votes lacking could not be obtained, and the bill failed. Mr. Breidenthal says that four legislators were bribed to vote against it.

Nearly ten years later, Governor Hoch, a Republican, called another special session for the same purpose. The deposit guaranty proposal was ably supported, and apparently sure of adoption, but, in the last few days of the session, the opposition succeeded in sidetracking guaranty by adopting a bill authorizing the formation of a company to insure deposits. Governor Hoch vetoed the bill as a worthless makeshift, and because, as he said, he would rather delay guaranty than have it on the wrong basis.

In the summer of 1908, however, the Democrats of Kansas, following the lead of the national convention, put into their platform a deposit guaranty plank. Many of the " progressives " in the Republican party — they are also known as " boss busters" — believed in bank guaranty, and believed that it would be popular in Kansas. It was, therefore, advocated in the Republican platform also. The Republicans won the election, and the legislature met in January, 1909, with both parties pledged to the guaranty of bank deposits. A system for the purpose, really an insurance system, was provided after a strenuous session, by the Act of March 6, 1909, which went into effect July 1st.

The Kansas law differs markedly from the law of Oklahoma. Perhaps the two most vigorous criticisms

of deposit guaranty have been that it compels good banks to pay the depositors of failed banks, and that incompetent or dishonest bankers will draw away the business of conservative bankers by paying extravagant interest on deposits. Moved by these criticisms the Kansas legislators made it optional with the banks whether to insure their deposits or not, and provided that no bank paying more than three per cent. interest on any class of deposits could insure any deposits whatever. To discourage the organization of new banks for the purpose of getting away the deposits of established banks, it was provided that, before participating in the guaranty plan, a bank must have an unimpaired surplus equal to ten per cent. of its capital, and must have been in business one year. National and private banks and trust companies that reorganize as state banks may, however, participate immediately. National banks, indeed, may participate as such, so far as the Kansas law goes; but are forbidden by the federal department from doing so. It is provided also that if no one of the existing banks in a town participates in the plan within six months after July 1, 1909 (when the law took effect), a new bank may then, if otherwise qualified, come under the plan at once.

The deposits insured are non-interest-bearing accounts, savings accounts of not over $100 each, and time certificates of deposit payable from six months to one year after date, and drawing not over three per cent. interest. This excludes the deposits of other banks, for these deposits are almost always on running accounts at from two to three per cent. interest. The assessments for the guaranty fund are levied not on the amount of deposits, but on the amount of deposits eligible to guaranty, less the

capital and surplus of the bank. This introduces a sort of classification of risks, — the only attempt at such classification in the guaranty law of any state. The larger a bank's capital and surplus in proportion to its deposits, the less will be its assessment or premium, and to this extent the Kansas law encourages the accumulation of capital and surplus. The assessments are to be made annually until the guaranty fund reaches $500,000. If the fund is depleted, as many as five assessments may be called for in one year. To guarantee the payment of the assessments, $500 for each $100,000 of deposits must be deposited with the State Treasurer in cash or in certain bonds.

The Kansas law requires the Bank Commissioner to examine rigidly each bank applying for permission to participate in the guaranty plan, just as the Oklahoma Commissioner did of his own motion. As participation is voluntary, so banks may withdraw from the guaranty by giving notice to the Commissioner. They must, however, pay all assessments that may be made on account of banks that have already failed and banks that fail within the next six months.

The assessments in the Kansas plan are small because no attempt is to be made to pay depositors in full on the closing of a bank. The assets, including the liability of the stockholders, are first to be realized upon. Only the loss remaining after the liquidation of the assets will be paid out of the depositors' guaranty fund. In the meantime, certificates bearing six per cent. will have been issued to the depositors, and it is expected that these can be sold or pledged to other banks, so that general business will not suffer as it frequently suffers when funds are tied up in insolvent banks. As in Oklahoma, so in Kansas, the

legislation for the insurance of bank deposits was accompanied by legislation providing additional regulations for banks.[1]

Once the deposit guaranty act was passed, it was undoubtedly the desire of most of the national bankers of Kansas to participate in the system. The maximum assessment could in no year exceed one-fourth of one per cent. of deposits, and the near-by example of Oklahoma seemed convincing as to the effect of deposit insurance upon the banks that provided it and the banks that did not. But the Comptroller of the Currency, Mr. Murray, held that national banks could not lawfully participate in the guaranty of deposits under the Kansas law. Through the Secretary of the Treasury, he asked for the opinion of Attorney General Wickersham whether national banks had the right to participate in the assessments and benefits of the bank depositors' guaranty fund of the State of Kansas upon the same terms and conditions as applied to state banks. Governor Stubbs, Bank Commissioner Dolley, and Attorney General Jackson, of Kansas, saw Mr. Wickersham in Washington March 31, 1909, and argued in the affirmative; but Mr. Wickersham's opinion, rendered April 6, 1909, was in the negative. He shared the opinion of his predecessor, Mr. Bonaparte, expressed in the Okla-

[1] Some of these are: —

A majority of the directors must be residents of the county in which the bank is located or of some adjoining county.

A stockholder to be eligible to the position of director or cashier must own at least five shares of stock, which shall not be hypothecated.

The Bank Commissioner may refuse to consider as a part of the legal reserve of any bank, balances due to the bank from any other bank, any of the stockholders of which are stockholders in such depositing bank.

Any officer of any state bank who may be found by the Bank Commissioner to be dishonest, reckless, or incompetent, shall be removed from office by the directors of the bank on the written order of the Bank Commissioner.

It is unlawful for any state bank, whether its deposits are insured or not, to accept deposits continuously for six months in excess of ten times its paid up capital and surplus. — Act of March 5, 1909.

homa case, that national banks have not the power to insure their depositors against loss. Mr. Wickersham said further that even had national banks such power, they had not the power to submit themselves, as required by the Kansas statute, to examinations and other forms of control by the banking department of the State of Kansas. "Only an act of Congress," he said, "can confer such powers upon national banks."[1] Senator Curtis and Representative Madison of Kansas introduced bills in Congress to grant national banks authority to participate in deposit guaranty systems, but no action was taken.

The national banks of Kansas had already held a meeting in Topeka, March 26th, to consider what their course should be. They decided to await the return of the Governor and his advisers from Washington, and agreed that if the final decision should be that national banks could not lawfully participate in the guaranty of deposits, the national banks would then organize a currency association under the Aldrich-Vreeland Act, believing that this action would assure depositors that there would always be a sufficiency of currency. It was further agreed that they would organize a company to insure bank deposits, both in national and in state banks.

Tho the currency association has not been organized, the organization of the Kansas Bank Deposit Guaranty and Surety Company is well under way. Of course, banks cannot, as such, subscribe for stock in an insurance company; yet it was desired that the banks should hold the stock. The difficulty was obviated in this way. Each bank that wished to aid in the organization of the Company had its shareholders appoint some one, usually the president of the bank,

[1] Report of Comptroller of the Currency, 1909, p. 94.

as trustee to hold the insurance stock in behalf of the shareholders. They authorized the payment to the trustee of a dividend of two and one-half per cent. of the capital and surplus of the bank, to be used to pay for stock in the insurance company. It will be recalled that the Attorney General of the United States is of the opinion that national banks cannot use their funds to pay premiums for the insurance of their deposits.[1] The premiums due the Kansas company are, however, to be paid not out of the funds of the banks insured, but out of special dividends duly declared, and, after such declaration, paid as premiums by the authority, previously given, of the shareholders individually. Dividends are not funds of the bank, but the property of the shareholders, and there is nothing to prevent the shareholders from using their own property to purchase insurance for the depositors. The premium rates have been fixed at fifty cents for each thousand dollars of deposits up to the amount of the capital and surplus of the insuring bank, and at one dollar for each thousand of deposits in excess of capital and surplus; that is, one-twentieth and one-tenth of one per cent. respectively, the former being the initial rate in the state system. This is analogous to the credit the state guaranty scheme allows for capital and surplus.

At the meeting of national bankers in Topeka, March 26, 1909, Mr. Dolley, the Bank Commissioner, was present and was not at all unfavorable to the plan of a deposit insurance company. He stated that he would be impartial and would leave the state banker to decide for himself whether to go into the guaranty system provided by the state or to take

[1] Under a later opinion, the same result may be accomplished by insuring assets in a certain way. Report of Comptroller of the Currency, 1909, p. 94.

out insurance in the proposed company. Later, Mr. Dolley changed his mind, and in speaking of the insurance company and the guaranty fund, at the annual convention of the Kansas Bankers' Association at Wichita, he said, "Every state banker should know where his home is."[1] In fact, there was fear that the state bankers would prefer to take out insurance instead of participating in the guaranty system provided by law; participation in Kansas being voluntary, and not permitted to banks that pay over three per cent. interest, even on time deposits. Now just as the Oklahoma limit of four per cent. is below the economic rate in parts of that state, so three per cent. is too low in a large part of Kansas, and not only national but state banks advertised that they would insure their deposits in the new company and continue to pay four per cent. interest. This competition might keep many banks from participating in the guaranty scheme and might draw away some of the depositors of the banks in the scheme. So serious was this possibility considered, that there was much talk of an extra session of the legislature to amend the law so that state banks could pay four per cent.; but the Attorney General of Kansas concluded that the Insurance Department of the state could forbid the company to insure the deposits of banks that paid more than guaranteed banks were allowed to pay.

The authorized capital of the Kansas Bank Deposit Guaranty and Surety Company is $500,000. Of this $346,550 has been subscribed and $257,850 paid in. It was even announced that the Company would begin to write insurance. Meanwhile, however, legal complications have arisen. A Nebraska law

[1] Proceedings Kansas Bankers' Association, 1909, p. 50.

for state insurance of bank deposits had been held unconstitutional by the United States Circuit Court. The Kansas law was attacked on similar grounds. Among the lawyers engaged to conduct the case against it were Senator Waggener, a Democrat, attorney for the Missouri Pacific Railway, and ex-Senator Long, a Republican, who had been defeated for re-election in 1909 by the "boss busters." The guaranty of deposits is a "boss buster" asset, and the "old crowd" would not be sorry to have it declared unconstitutional. On December 24, 1909, the Circuit Court granted a temporary injunction against the enforcement of the act. The case was to be appealed to the Circuit Court of Appeals. But it is now stated that a special session of the state legislature will be called to amend the law; such an extra session being expected to cost less than sustained legal proceedings. A suit to test the validity of the law under the state constitution is also pending in the Kansas Supreme Court. Hence the legal situation and the mutual outcome are still involved in uncertainty; and the Deposit Guaranty Company is not yet ready to do business.

No attempt can be made here to enter on the legal question. But all this litigation proves one thing of significance. The fact that it seemed worth while to raise a fund and engage in litigation proves that even bankers opposed to the principle of insurance of deposits through a fund administered by the state, realize that such insurance makes a powerful appeal to the people, and will affect the distribution of deposits.

Many new state banks were organized in Kansas in 1909. Banks organized after March 5, at points where there are banks already, cannot have their

deposits insured for six months or a year, but in some towns that had banks, as well as in some that had not, the organization of new banks was somewhat hastened by the idea that deposits would come more easily once a bank was under guaranty. Eighty-seven state banks were organized from September 1, 1908 to December 17, 1909, thirty-eight of them in towns that had no banks before. Six national banks, of which one was a reorganization, were organized from October 31, 1908, to December 23, 1909. All of these were in towns that had banks already. About ten national banks have been converted into state banks.[1]

As in Oklahoma, so in Kansas, the establishment of a system of deposit insurance has led some of the state bankers to the conclusion that their interests are no longer identical with those of the national banks. They have, therefore, organized the Kansas State Bankers' Association, which is wholly independent of the Kansas Bankers' Association, and, like the older organization, will procure fidelity bonds and burglary insurance for its members.

By the middle of September, 1909, 451 banks had applied to have their deposits guaranteed, and 229 had paid their assessments, deposited their bonds, and were under guaranty. Some of the applications had been made by banks that did not intend to go into the system at once, but applied in order that they might receive the necessary examinations and be ready to go in without delay should it prove advisable later to do so. On September 28, 1908, Bank Commissioner Dolley stated to the press that "the banks that have applied for participation have a combined capital stock of $7,350,000 and a combined surplus of $2,140,000. The combined capital stock of banks

[1] See the appendix for items from recent statements of Kansas banks.

that have not applied is $5,930,000 and these banks have a surplus fund of $1,680,000." The Commissioner concluded that "the stronger state banks of Kansas believe in the guaranty law and have availed themselves of opportunities to at once come under its provisions." On the same date, according to a letter from the Commissioner, 300 banks were actually in the guaranty system. By the end of October, 365 were in. The amount in the guaranty fund December 17 was $17,000, besides $276,876 of bonds and cash deposited to guarantee payment of future assessments. This would indicate about $40,000,000 of individual deposits in the guaranteed banks. The Kansas banks are splendid risks now. Their customers are prosperous. Alfalfa and cattle have made a great change in Kansas agriculture since the days when wheat and corn were almost the only dependence of many farmers. Mining and manufacturing flourish also in many places. The state is rich. It is to be remembered, too, that the Kansas fund will be used only to pay losses finally ascertained at the winding up of failed banks, and that four additional assessments equal to the one now paid in could be levied within a year. Nevertheless, a fund of $17,000 is a small one for starting an insurance business with $40,000,000 of risks.

As the law went into effect only July 1, 1909, and as banks have been going into the guaranty system ever since, the Bank Commissioner has given out no statement of the effect of the guaranty law on the deposits of the banks that have accepted its provisions. The effect is probably slight. There are some stories that money has come out of hiding and gone into the banks; and the advertisement of the guaranty has increased the deposits of some banks.

The time has been short and the multifarious litigation confusing. The scheme has not been so thoroly advertised by talk and print as in Oklahoma. Indeed, the smallness of the fund has been criticised with effect, and there is no popular interest in the subject. The guaranty of deposits has had as yet no real test in Kansas. None the less, such small results as have been observed bear out the evident expectation of the bankers who organized the insurance company, and of those who instituted court proceedings, that deposits, if adequately insured, would grow.

## Nebraska

In Nebraska also deposit guaranty is not a new proposal. In every session of the legislature for nearly twenty years there have been one or more bills for the guaranty of bank deposits. In the days of the Populist party, one serious attempt to pass a guaranty bill was defeated partly through the efforts of Mr. Shallenberger, who, curiously enough, was long after, in 1908, elected Governor by the Democrats on a deposit guaranty platform. In that year the Democratic campaigners had made much of deposit guaranty on the stump. The Republicans had not met them on the issue; in fact, their nominee for Governor, ex-Governor Sheldon, had rather favored the proposal. It is said that a majority of the members of the legislature were never convinced of the wisdom of guaranty legislation, and that, notwithstanding campaign pledges, there might have been no such legislation but for the personal influence of Mr. Bryan, who insisted that promises be redeemed.

Deposit guaranty, or insurance, was provided by the Act of March 25, 1909. Its chief provisions in

comparison with those of the laws of other states have already been indicated.[1] Participation in the guaranty is compulsory for all state banking institutions. No provision is made for national banks. Four assessments, each amounting to one-quarter of one per cent. of average deposits, are to be made by the State Banking Board between July 1, 1909 (when the law was to take effect) and January 1, 1911. Thereafter, semi-annual payments of one-twentieth of one per cent. of deposits are to be made. Special assessments not exceeding one per cent. in one year may be levied to restore the fund if depleted. The assessments are not to be paid over to the State Banking Board, but each bank is to credit the amount assessed against it to the State Banking Board, payable on demand. This is an arrangement that might easily lead to trouble. Insurance premiums, for that is what these assessments are, should be paid over to the insurer, not held by the insured, subject to all sorts of claims and processes if the insured happens to think his insurance is proving too expensive.

All deposits are insured, and the deposits of every failed bank are to be paid in full as soon as the deficiency in the cash turned over to the receiver is determined. The State Banking Board will obtain funds to meet the deficiency by drawing checks against the assessment accounts standing to their credit in all the state banks.

The act made the regulation of banking more stringent in several particulars. The minimum capital of banks thereafter organized was increased. The qualifications of directors were made in some respects more exacting than are the qualifications of the directors of national banks. Most important regulation of all,

[1] See the table opposite p. 88 of the November issue of this Journal.

the act limited banking to corporations, and forbade individuals and firms to carry on the business.

At the time of the passage of the act, there was some activity in organizing state banks, but the Secretary of the State Banking Board, in a letter to the writer, expresses the opinion that few banks have been organized for the purpose of taking advantage of the guaranty law. No national banks converted for the purpose. "Several state banks, however," he says, "have nationalized in order to get out from under the new law, and several more would have done so had the law gone into effect."

The law is not yet in effect and may never be. Many state banks and two private banks obtained from the United States Circuit Court an injunction prohibiting the state authorities from putting the law in operation. The same questions were raised as in the Oklahoma case, whether an assessment for the deposit guaranty fund would be a mere police regulation of the conditions under which the business of banking should be carried on, and so within the power of the state to levy; or whether it would be depriving sound banks of their property without process of law, and turning that property over to the depositors in unsound banks. There was raised also the question whether the state could constitutionally legislate its thirteen private banks out of existence. The Court expressly declined to rule upon either of these points separately, but held that taken together they established the invalidity of the act.[1] The

[1] "The act not only attempts to exclude individuals from engaging in the banking business, unless they do so through the agency of a corporation, but also attempts to impose upon them, as a condition to their engaging in that business even in that form, a duty to make good the obligations of all other bankers in the State to their depositors." . . . "we are of the opinion that this cannot be done consistently with the 14th Amendment to the National Constitution." First State Bank of Holbein, et al, *vs.* Shallenberger, Governor; Journal of American Bankers' Association, vol. ii, p. 187.

case has been appealed to the United States Supreme Court. Meantime, neither the additional regulations of banking provided for by the act nor its guaranty provisions are in effect.

Altho the experiment of deposit guaranty has thus not yet begun in Nebraska, one can see, from the politics and the litigation, as in Kansas and Oklahoma, that bankers naturally oppose deposit guaranty and deny its necessity, and yet that very many of the people are expected to place their deposits under it if given a chance. Bankers, to do them justice, fight the scheme not only because they expect it to move some deposits from long established banks to new institutions, but because they think such removal will tend to encourage unwisely liberal, even reckless methods, to the ultimate loss of the community, especially the banks. This possibility can, however, best be discussed after our review of legislation is completed.

## South Dakota

Tho manufacturing and the wholesale trades are progressing rapidly in the states whose recent banking history we are considering, the interests of the group remain predominantly agricultural or pastoral. This is particularly the case with South Dakota. The people had plenty of wheat, flax, oats, corn, cattle, horses, sheep, and hogs for sale, and the panic of 1907 was soon forgotten. Only one bank failed in the state in three years preceding the deposit insurance legislation of 1909, and that bank paid one hundred cents on the dollar. Probably there would have been no attempt at deposit insurance legislation had not the Democratic state convention followed the

national convention by putting a guaranty plank into the state platform. Not to be outdone by this vote catcher, the Republicans also indorsed the guaranty plan, so that it was in the platforms of both parties, just as it was in Kansas.

The Republicans, it will be remembered, carried the state; and their advocacy of the new plan became cool. With the scheme in the platforms of both parties, however, there seemed to be no way out, and it became a question, apparently, of how little could be consistently done.[1] The provisions of the scheme adopted in the Act of March 9, 1909, have been outlined. Like the Kansas plan, the South Dakota plan is voluntary. But while a single Kansas bank could take the state-administered deposit insurance, and by paying its initial assessment establish a guaranty fund, it would take one hundred banks to set the South Dakota plan in operation. One hundred banks, or more, could organize "the State Association of Incorporated Banks." The membership fee would be from $100 to $170 each, according to capital. The annual premium would be one-tenth of one per cent. of the deposits, except public deposits otherwise secured. In case of need, special assessments might be levied, not exceeding in any year four-tenths of one per cent. of deposits. Out of the fund thus established the depositors of failed banks would be paid. If the fund were insufficient at the time of a bank failure, the subsequent accumulations of the fund for the year covered by the last premium paid by the insolvent bank would be paid to depositors pro rata. Depositors would apparently lose what was unpaid at the expiration of the premium year.

[1] One banker said in a letter to the writer: "The law which they passed is considerable of an abortion and the intention in passing the same was to make it so abortive that it would neither hold water under the Supreme Court, or that no bank would take it up."

It was probably not expected by many that an Association would be formed under the act. Perhaps half a dozen banks have written the Public Examiner asking if any movement were under way to organize an Association, but there has been no movement, and the matter has dropped.

The legislature, however, passed an excellent general banking law. The Act of 1903, amended in 1907, was a comparatively short law, not so definite or particular as is now deemed advisable in banking legislation. The Act of 1909 increases the minimum capital of a state bank to $10,000 or more, according to population. Directors, while still eligible if owning five shares, must own these free of pledge. Directors, or a committee of stockholders, must examine their banks twice a year and report to the Public Examiner what they find. The Public Examiner is allowed two additional examiners on his force. These and other provisions will strengthen the banks and the Public Examiner's department.

The South Dakota banks have been given the opportunity to effect insurance for the benefit of their depositors, but have not done so because not required by law. For two reasons, this is different from the course of hundreds of Kansas bankers under a voluntary plan. First, the Kansas plan is more flexible, being available to individual banks. Second, the Kansas bankers were induced to avail themselves of the plan by the apparent early success of the neighboring Oklahoma plan, similar but compulsory. The recommendation of the Kansas Bank Commissioner to the banks under his supervision also contributed to the result observed in Kansas.

It is not likely that the South Dakota plan will ever be used at all.

## Texas

As in Kansas, Nebraska, and South Dakota, the first distinct impetus to deposit insurance legislation in Texas was furnished by the Democratic national platform. The loyalty of Texas to this party is proverbial, and it was almost as a matter of course that the state convention adopted a similar plank. It is doubtful, however, if even party regularity would have been a sufficient force to pass a guaranty bill without the strongly exerted influence of the Governor and of Bank Commissioner Love, both firm believers in the wisdom of the plan. They were reinforced by Mr. Bryan himself, who, while on a visit to the state, visited the legislature and advocated the guaranty of bank deposits in a speech from the speaker's stand. The bankers in the cities were, as a rule, opposed, but many of the country bankers favored the guaranty scheme, as a preventive of panic and a builder of deposits. The failure of the Western Bank and Trust Company of Dallas under discreditable circumstances was comparatively recent, and had left a pronounced sentiment in favor of some measure that would in the future afford depositors reasonable assurance of safety.

Notwithstanding politics, official pressure, and a favoring sentiment on the part of some banks and much of the public, the regular session of the thirty-first legislature adjourned March 12, 1909, without action on the subject. The Governor issued a call March 13 for a special session to convene the same day, and gave as one of the purposes of the session that of enacting legislation to guarantee bank deposits. This "called session," however, adjourned

April 11, without passing a guaranty bill. The Governor then called still another session to meet the next day. This second "called session" gave Texas a guaranty law. It went into effect August 9, 1909, and under its provisions, the guaranty plan went into operation January 1, 1910.

Under this law any bank has nominally an option whether to protect its depositors by contributing to a guaranty fund or by filing annually with the Commissioner of Insurance or Banking, "on behalf of its depositors," "a bond, policy of insurance, or other guaranty of indemnity in an amount equal to the amount of its capital stock," or if a private bank, "in an amount to be fixed by the Commissioner of Insurance," but in no case less than one-half the average deposits of the preceding twelve months. Incorporated banks must file additional security when their deposits exceed six times their capital and surplus.[1]

Now a policy of insurance or a bond procured from some surety company for the benefit of the depositors would cost at present rates one-half of one per cent. of the deposits, while the annual assessments, under the guaranty fund plan, are to be, except in emergencies, only one-fourth of one per cent. If resort is had to individual sureties, there must be at least three of them. Most bankers would hesitate to ask customers, even directors, to sign a bond equal to the whole capital of the bank so to be guaranteed, and most customers or directors would hesitate to sign even if the request were made. Moreover a personal bond, made, as it would be, by the active management or by its close friends, would reassure few depositors in uneasy times and would attract

[1] Sections 15 and 22 of Bank Guaranty Law effective August 9, 1909.

few new depositors in good times. If the management turned out bad, the bond would not often be much better, and experience proves that even solvent sureties would usually seek in every way to avoid payment. As a matter of fact, only 42 banks had chosen the bond security plan on October 1, 1909, by which date all the banks operating under the Texas banking law were required to elect which form of security they would provide for their depositors.

There are provisions in the Texas law permitting national banks to avail themselves either of the guaranty fund plan or of the bond security plan. Under the opinions of Attorney General Bonaparte and Attorney General Wickersham, on the Oklahoma and Kansas laws, the former plan is not open to national banks, but doubtless any national bank could file a bond to secure its depositors, provided it did not, as a bank, pay anything for such bond.

The outline of the Texas guaranty fund plan is like that of Oklahoma, with interesting variations. It applies to incorporated banks. The initial assessment is one per cent. of average deposits for the year ending November 1, 1909. The regular annual assessment is one-fourth of one per cent. of average deposits, but in emergency the total assessments for any year may run to two per cent. of deposits. Twenty-five per cent. of these assessments is to be paid by the banks to the State Banking Board, and will be deposited by the Board with the State Treasurer. Each bank will credit on its books seventy-five per cent. of each assessment upon it to the State Banking Board, subject to check. This retention of part of the assessments follows the law of Nebraska, where all the assessments were to be paid in the first instance by this book-keeping device. The scheme is a defect

in the laws of both these states. Some Oklahoma banks seriously contemplated resisting the payment of the drafts of the State Banking Board for the recent emergency assessment, and many more banks were exceedingly restive. In Texas and Nebraska the banks would hate to see the guaranty fund drawn upon, even tho carried on a separate ledger page. Checks by the Banking Boards might prove a precarious resource. It would be better to collect all assessments at once and keep the fund in the State Treasury or in marketable securities.

The maximum amount of the Texas guaranty fund is $2,000,000. After the fund reaches that figure, the only further assessments will be to restore it when temporarily reduced. As in Oklahoma, it is provided that depositors shall be paid in full on the closing of a bank. This, as Oklahoma experience shows, cannot be promised safely.

The Act of 1909 provided additional general regulations of banking, such as have been adopted in all the states in which there has been deposit insurance legislation, and partly because of it. If bankers are responsible for each other, they desire that all shall be required to conform to adequate regulations. Probably the most interesting and important of the new Texas regulations is the attempt to establish a relation between deposits and capital. We have seen that banks under the bond security plan must file additional security if deposits exceed six times capital and surplus. It is further provided that capital must be increased as deposits increase. If, for instance, the deposits of a bank of $10,000 capital average for a year more than five times its capital and surplus, the bank must increase its capital by twenty-five per cent. So banks with capital up to

$20,000, $40,000, $75,000, $100,000, and over $100,000 must increase capital by twenty-five per cent. when deposits exceed six, seven, eight, nine, and ten times their respective present capitals. Other changes are in provisions for examinations quarterly instead of annually, and limiting the liabilities a director may incur to his bank.

The total number of elections of the guaranty fund plan to December 29, 1909 was 493, and of the bond security plan (as stated above) only 42. Existing banks were required to make their elections not later than October 1, 1909. The failure in an adjacent state of the Columbia Bank and Trust Company of Oklahoma City, at the close of September, seems not to have caused the Texas bankers to fear that in choosing the guaranty fund system they had chosen the wrong plan.

One indication of the attractiveness of guaranty deserves mention. The Texas constitution of 1876 had forbidden the incorporation of banks.[1] A great many private banks grew up, and there were some existing charters that the constitution could not abrogate. Many of these gave exceedingly wide powers, like the charters under which banking was sometimes conducted in connection with various other business before the Civil War. The Western Bank and Trust Company of Dallas, for instance, was a cotton factor. These charters have been much used of late years, and parent institutions have established numerous branches. After a change in the constitution, a general banking law was adopted in 1905, and many banks were incorporated. The Bank Guaranty Law of 1909 has now provided that,

[1] "No corporate body shall hereafter be created, renewed, or extended with banking or discounting privilege." Art. xvi, Sec. 16, Const. of Texas, 1876.

by discontinuing branches, institutions operating under special charters may avail themselves of either the bond security plan or the guaranty fund plan. A remarkable instance of the effect of the guaranty law appeared in the case of the Continental Bank and Trust Company, of Fort Worth, which has discontinued its thirty branches, and has reorganized them as separate banks, all of them electing the guaranty fund plan.

No fewer than eighty-nine state banks were organized between June 20 and December 29, 1909, with a total capital of $3,167,500. Eight were conversions of national banks. Tho this activity in bank organization must be ascribed chiefly to the present rapid development of a wonderful state, the fact that banks can attract deposits more rapidly under a system of deposit guaranty has undoubtedly in some cases made possible the establishment of banking facilities sooner than they would otherwise have been provided. This consideration must not be exaggerated, however. The organization of eighty-nine banks in so few months is striking, but not wholly exceptional. There was an increase of eighty-six in the number of Texas state banks and trust companies between the May statements of 1907 and 1908, long before the guaranty legislation.

In the Appendix[1] are some figures from recent Texas bank statements.

As the guaranty of deposits in Texas banks began only on the first of this year, there are no comparisons to be made. So far the Texas law has not been attacked in court. As the largest commonwealth in the United States, it is a wonderfully interesting field for a financial experiment, and the result will be important.

[1] See p 391.

## Colorado and Missouri

The bank guaranty scheme was proposed in the legislatures of many other states, but failed of adoption. Of these cases the legislative experiences of Colorado and Missouri are, perhaps, the most interesting.

In Colorado the Democrats, following the example of the national convention held in Denver, put a guaranty plank into the state platform, and, being successful in the election of 1908, brought the guaranty matter forward in January, 1909, early in the session of the Legislature. The matter was fought over until April. The guaranty bill was a carefully drawn measure, providing for the accumulation of a fund of one per cent. of the deposits. Of this fund, two-fifths was to be paid in at once, and one-fifth each year thereafter. In case the fund should be impaired, special assessments to replenish it might be made, not exceeding one per cent. of the deposits in any one year. The interest to be allowed on deposits was limited to four per cent.

It is only of recent years that Colorado has had an adequate banking law, and there was no Bank Commissioner until 1908. Some good sized bank failures had occurred. This fact reinforced the political situation, and apparently strengthened the chances of the bill.

The Colorado Bankers' Association actively opposed the bill, on the familiar ground that it would force good banks to pay the losses of the bad. The Democratic legislators, however, felt obliged by the party platform to pass some kind of a guaranty bill, and there was prepared and introduced what became

known as the Individual Guaranty Bill. This provided that each bank must set aside each year one per cent. of its deposits until it had so accumulated a fund equal to ten per cent. of its deposits. This fund was to be invested in bonds or warrants approved by the Bank Commissioner, and the bonds and warrants were to be delivered to the State Treasurer. In case of the insolvency of the bank, the securities were to be turned over to the receiver for the pro rata benefit of unsecured depositors. The fund could not be used to restore impaired capital. If the capital became impaired, but the banks did not become insolvent, the impairment would have to be made up by assessment on the stockholders; the so-called guaranty fund remaining intact for the benefit of depositors in case of insolvency.

The Colorado bankers felt that in this unique and interesting bill they had hit upon a good solution of the guaranty problem, by providing for the establishment of a large fund that would stand as a buffer between the depositor and the losses his bank might make on its investments. The objection to the plan would seem to be that it would require banks to invest largely in long-time securities. Colorado is industrially a comparatively new state, and has need of active working business capital. It would seem that its banks should for the present confine their investments to commercial and agricultural channels.

The Individual Guaranty Bill was strongly urged, and the legislative situation grew into a deadlock. The Legislature adjourned in April, without passing either the Mutual Guaranty Bill or the Individual Guaranty Bill.

When the Missouri Legislature convened in January, 1909, the Democrats were in control of the Senate, while the Republicans were in control of the House. Throughout the session there was much playing of politics. The Governor recently elected was Herbert S. Hadley, the first Republican Governor Missouri has had in a generation. A banking law adopted by the previous legislature went into effect January 15, 1909. This law created the office of Bank Commissioner. Until then, the state banks and trust companies of Missouri had been supervised by the Secretary of State. This office had been filled under the previous administration by John E. Swanger, a Republican, and Governor Hadley appointed Mr. Swanger to be the first Bank Commissioner, in view of his ability and experience. Mr. Swanger desired to have the banking laws of the state again revised, and caused to be introduced both in the Senate and the House a bill for the purpose. Prior to the introduction of this Bank Revision Bill, Senator Lane had introduced in the State Senate a guaranty bill along the general lines of the first Oklahoma measure. His bill, however, provided for a smaller fund; only one-fourth of one per cent. of the deposits, this to be kept up by annual assessments upon which no limit was placed. It was attached in the Senate to the Bank Revision Bill which, therefore, passed the Senate and went to the House embodying a bank guaranty scheme. In the meantime, the House had passed Mr. Swanger's Revision Bill, and sent it to the Senate. The Senate attached Senator Lane's bill to the House Bill also, and sent it to the House for concurrence in the deposit guaranty amendment. The House neither passed the Senate bill, however, nor concurred in the Senate's amendment to the House

Bill, and, as the Senate would not recede from its position, the desired revision of the banking law failed.

The Banking Department of the State of Missouri is supported by the examination fees of the banks, and an important part of the revision bill had been a very proper and necessary increase in these fees. On account of the failure of the revision law because of the legislative deadlock of the Senate and the House over the deposit guaranty question, Commissioner Swanger was confronted by the necessity of curtailing the work of his department or of raising the money outside the State Treasury. Some of the larger banks of the state are, at the Commissioner's suggestion, carrying the salary warrants issued to the Commissioner's force, and it is expected that the next Legislature will appropriate enough money to cover the deficiency.

The experiences of Missouri and Colorado with the deposit guaranty bills illustrate the intense feeling that has attended the working out of the question in the West.

## Deposit Insurance by Private Corporations

It has long been possible for a depositor to procure insurance of his deposit, or for a bank to procure insurance on behalf of a particular customer (usually a public officer depositing public funds) covering in a specified amount. The rates have been ordinarily one-fourth of one per cent. per annum. Recently some of the large companies have doubled the rate. Many Oklahoma national bankers have believed that, unless Congress should authorize them to participate in the state guaranty plan, they would have to insure

their deposits in order to compete with the state banks.[1] It has been suggested that the leading surety companies might combine to issue a joint policy. Seventeen of the companies have a total capitalization of about $35,000,000, and their joint policy would be good.[2]

The organization of an insurance company in Kansas by national bankers and some state bankers has been recounted in our study of the Kansas situation. Another company is being promoted in Kansas City. It has received much encouragement from Oklahoma and, since the Circuit Court's decision of last December, from Kansas. Another is organizing in St. Louis.

Some of the companies doubt whether it is possible to write deposit insurance at all generally. If so, should the companies guarantee the repayment of all a bank's deposits, whatever they might be, or should the policies be for definite amounts ? Should a policy be paid on the closing of a bank, or within a certain time thereafter, or only when liquidation had been completed ? These problems are as yet unsolved.

Of course, depositors would at the outset have more confidence in a state guaranty fund than in the insurance policy of any company. Even if the state system broke down, the state would see that all losses were ultimately paid, as did New York after the collapse of the Safety Fund System.[3] If the insurance

[1] This they can do under some policy forms. Opinion of Attorney General Wickersham in Report of Comptroller of the Currency, 1909, p. 94.

[2] N. Y. Herald, May 28, 1909.

[3] It is fortunate that the Monetary Commission is to include in its publications a study of the New York experiment. [The Safety Fund Banking System in New York State from 1829 to 1866, by Dr. Robert E. Chaddock.] The only study available has been that of John Jay Knox, in his History of Banking. Mr. Knox says that the Safety Fund System failed because it covered deposits as well as notes, but the facts he sets out are not sufficient to test his conclusion. Evidently politics and fraudulent note issues played an important part.

companies were solvent and carefully administered, however, the public would soon repose confidence in them, as it does in fire insurance companies.

The companies may be expected to have a favorable loss experience. They will employ good bank examiners and select risks with care. It has been suggested that only the weaker banks would apply for insurance, but this is disproved by the experience of Kansas. Some of the strongest banks in that state were participating in the guaranty plan at the time its continuance was enjoined, altho the fund, as we have seen, was too small to appear reassuring to depositors. It may fairly be expected that strong banks would take out insurance in a company organized with large paid up capital by good business men.

The loss experience can be helped in another way. If an insurance company learns that one of its risks is in difficulty, it can often, after ascertaining the exact situation, obtain additional security from the stockholders, and put into the bank enough cash to enable it to continue business. The stockholders would almost always rather give security than let the bank close and pay the assessments that usually follow. The insurance companies would rather put in cash by way of loan than let the bank close and pay the policies. It is the intention of the organizers to take this course wherever possible.

One objection to state-administered deposit insurance has been the apparent necessity of a large degree of state control of the operation of banks. This control is exercised by limiting deposits and limiting interest payments; the objections to it will be more fully considered later. These limitations reach few of the possible elements of bad management. Insurance companies could reach many others by granting

or withholding insurance in specific cases. If deposit insurance has commercial utility, — and we have seen that in some places it has, — private corporations can furnish it satisfactorily. The restraint thus exercised by the companies would not have the injurious effects of excessive state regulations.

## General Arguments and Conclusions

In the experiences of the states that in the last two years have adopted or seriously considered deposit insurance legislation, we have found strong conflicting tendencies at work. In Oklahoma, the time has been too short for definite conclusions, and in other states the experiment of deposit insurance has either not begun, or hostile litigation has obscured the results. Let us, therefore, take up the general arguments for and against the insurance of bank deposits, and consider them in the light of such facts as have been developed in the foregoing study. In the considerable volume of recent discussion on this subject,[1] the following are stated to be the chief purposes of deposit insurance: —

(1) The prevention of the individual distress that always follows a bank failure. The statistics that prove how comparatively rare bank failures are, and how infinitesimal the ultimate loss is, are not valid as a measure of the blighted ambition and the "wreck of happiness" that follow the closing of banks.

[1] Government Insurance of Bank Deposits, edited by Rollo L. Lyman (The H. W. Wilson Co., Minneapolis, 1908), contains excerpts from essays on both sides of the question. See also Guaranty of National Bank Deposits, by James B. Forgan of Chicago; Guaranty of Bank Deposits, by Prof. J. Laurence Laughlin; addresses by Charles H. Huttig, Festus J. Wade, and H. P. Hilliard of St. Louis, Andrew J. Frame of Waukesha, Ill.; and editorials in the Commoner, Lincoln, Nebraska.

(2) Another and different purpose is to prevent the embarrassment in other lines of business that has heretofore followed the closing of banks. Deposit insurance will accomplish this purpose, its advocates say, either by paying deposits immediately, or by furnishing depositors with interest-bearing certificates for the amount of their claims, the ultimate payment of these certificates being insured. Other bankers will, it is said, undoubtedly buy the certificates, or accept them as collateral for loans to business men. Assuming the insurance to be good, the writer believes that other banks would take this course. Even without insurance, banks now frequently take the business of depositors who have money tied up in failed banks, and lend on assignments of claims for the tied-up funds.

(3) Still another purpose is the prevention of financial panics, by assuring depositors of the safety of their funds. It is argued that, being so assured, depositors will not run upon the banks. It cannot be doubted that the insurance of deposits would now and then prevent a bank run. But such runs as have anything to do with general financial panics are symptoms and not causes. The causes are usually to be found in over-expansion of trade, or in untenable speculative situations, and neither of these causes can be reached by deposit insurance. The most that such insurance could do would be to mitigate the effects of a panic by assuring depositors of the ultimate safety of their deposits. Yet it would mitigate them. Tho much money would be drawn out of banks by depositors who felt that they could not afford to have their funds tied up even temporarily, a great deal would be left in the banks by depositors who would otherwise draw out their deposits in cash.

In 1907 the largest bank in the Southwest closed after a practically continuous run of more than a month. So far from losing all its deposits in those long and desperate weeks, the bank closed with half its deposits still on its books. All depositors cannot be classed together. Some are so frightened by the least rumor that nothing can satisfy them but the withdrawal of their deposits in money. Others are not frightened at all. Between these two classes is the great bulk of depositors, more or less uneasy, but reluctant to aggravate the situation by joining a run. Bankers who have observed depositors in like circumstances agree with the writer in saying that most of this great middle class would let their deposits stay if assured of ultimate safety.

(4) Deposit insurance has been advocated to prevent the closing of sound banks by runs. Sound banks, however, are not closed by runs. Now and then a bank is injured by a senseless run, but if it is thoroly sound, it does not close.

(5) Deposit insurance, if otherwise successful, will, of course, make it profitable to establish additional banks.

(6) Economically, the most important purpose of deposit insurance is to increase the use of banks by the general public. The amount of money hoarded in the United States is enormous. The well known investment of savings in Post Office Money Orders, and the heavy remittances by immigrants to foreign banks, indicate that large numbers of people fear to deposit in American banks. Again, every country banker can tell of farms paid for in his office with money damp from long burial in cellars or under refuse heaps. Every city newspaper has frequent stories of some washwoman being robbed of the

savings of years, or some mechanic whose wife forgetfully lights a fire in the old stove and burns the hidden money. Nor is it only laboring people and the ignorant who distrust all banks. The safe deposit vaults hold the money of clerks, real estate owners, and even business men, by the millions and millions. Money to the amount of $1,660,000,000 in the United States is neither in the Treasury, nor in the banks.[1] Much of it is in circulation, but a vast amount of it is hoarded. How much, one cannot even guess.

Here the Oklahoma experiment is in point. Given deposit insurance in which the people have confidence, there will be less hoarding of actual cash, and people will use banks more. The effect will be cumulative, for as people who are now ignorant of banking customs become familiar with such customs, their resort to banks for all kinds of financial business will rapidly increase, to the social good.

Let us now consider the objections.

(1) The chief objections urged against the insurance of bank deposits are that it is unnecessary and that there is only a small demand for it. The small aggregate losses to depositors in national banks since the establishment of a national banking system in 1863 are referred to in support of this argument. The average loss is variously calculated. Mr. James B. Forgan, of Chicago, has calculated it to be one-twenty-sixth of one per cent. per annum, but the writer can arrive at this result only by omitting from the calculation the losses on receiverships not finally closed, and these losses will be considerable.[2] The Comptroller of the Currency has calculated the loss to be

[1] Report of the Comptroller of the Currency, 1909, p. 62.

[2] Guaranty of National Bank Deposits, by James B. Forgan, p. 12.

about one-seventeenth of one per cent., but, while taking the total known and estimated losses on all classes of deposits, he figured his percentage on individual deposits only, not including the very considerable item of deposits by banks.[1] The writer, taking these omitted elements into consideration, estimates the average annual loss on deposits in national banks to be one-twenty-second of one per cent.

Now this loss, while infinitesimal, deters a great many people from depositing in banks, for the reason that people do not know what institutions will fail. It is suggested, of course, that such a fear is unreasonable. "Let the people pick out good banks to do business with," say the opponents of deposit insurance. But in too many cases the people cannot pick good banks. Not only in the country, but in the city, a large number of people have not and cannot get the necessary information to enable them to determine whether a given bank is good or not. A few banks stand out in their communities pre-eminent for strength and conservatism, but these cannot do all the business, and every now and then one of these very institutions fails. To say nothing of laborers and small tradesmen, even the great business man usually knows only by general reputation whether a bank is good or not. He cannot know of all of the bank's investments. Altho in touch with the affairs of the community, he is dependent on current gossip for any details he may chance to learn of those transactions that impair a bank's solvency.

The closing of any bank is a surprise to the very directors. Few of its depositors can have had any reasonable chance to learn anything about it. Whom could they have asked? The directors? They

[1] Report of the Comptroller of the Currency, 1908, p. 86.

were deceived themselves. The big business men of the city ? If they had their misgivings they would not have communicated them. Did they inquire as to the general reputation of the management, the answer would be almost invariably, " reputation all right." The crash of failure comes upon the depositor almost always without his having had personal warning or any practical opportunity to obtain it. Tho there may be little active demand for bank deposit insurance (it is a novel matter anyway), it is not true that there is no need for such insurance. The advisability of giving the holder of a bank's notes protection additional to that afforded by the particular bank has long been recognized. Until comparatively recent times, the liabilities of banks were chiefly notes. Now the liabilities are chiefly book credits, — deposits. It may be time that depositors should cease to be dependent upon the fortunes of a single bank in a single place.

(2) Another question raised has already been considered; whether deposit insurance will prevent financial panics. The conclusion seems inevitable that while panics cannot be prevented, good deposit insurance would mitigate some of the effects.

(3) Another series of objections is usually stated by way of *reductio ad absurdum.* The existence of good deposit insurance being assumed, it is argued that the insurance itself would lead to impossible conditions, and that the insurance system would, therefore, break down.

The simplest form of this reasoning is that deposit insurance would make deposits in a poorly managed bank as safe as those in a well managed bank. But this is not quite true, if we are correct in believing that deposit insurance should not be paid until after

the liquidation of the assets of the insolvent bank. With such a provision in laws or policies, there would still remain a sufficient incentive to depositors to seek banks operated by careful and prudent men.

Again, it has been offered as an argument against the Oklahoma plan, that if the qualities of honesty, care, and skill would not make one bank safer and therefore more attractive for depositors than another, so enabling the possessor of these qualities to excel in banking; then honest, careful, and skillful men would go into some other business, leaving the field to men of weaker character and inferior ability. This, it is alleged, would result in such deterioration of bank management as to destroy the deposit insurance system, if not the banking system itself. But would men of integrity and strong character avoid the field of banking if the deposits of their competitors were insured? Is there no difference between banks except in safety? The incentive to good management in banking is not the mere desire to avoid failure. If the banker manages ill, his bank will pass out of existence, to his financial loss, whether its depositors are insured or not. Deposit insurance is not stockholders' insurance. Stockholders must lose all their money before depositors collect any insurance at all. With insurance in force, stockholders would need and have just as careful officers as now. The careful, skillful, and honest would still succeed; the reckless, incompetent, and criminal would fail.

It is argued, however, that liberality in loans or in interest rates would then be the chief inducement to depositors. It is supposed that much loss would result, and that, if the unwise banking methods predicted did not lead to wholesale bank failures, they would, at least, result in a great waste of capital

and a corresponding economic loss to the country. This argument has its force; there would be some waste. There has been waste in Oklahoma, some of it attributable to deposit insurance. All insurance causes waste. But good insurance prevents more than it causes. On the whole, fires are not more but less because of insurance. It is reasonable to hope, altho impossible to prophesy, that deposit insurance, by stimulating good banks and increasing their number, will lead to a higher average of management, and to less waste than at present. Failure and waste, under any proper deposit insurance system, will continue to be sporadic only, and probably not more frequent.

As deposits are created largely by loans, it has been suggested that loans might be made fraudulently, and payment of resulting deposits be required out of the insurance fund, while the loans could not be collected. The answer to this is that practically the same opportunity exists now. It can just as well be supposed that crooks would start an unguaranteed bank now, attract some deposits, purposely make some bad loans, credit the loans up as deposits, and pay the fraudulent depositors with the funds of the good depositors. It is not necessary to introduce the guaranty of bank deposits to provide bankers of criminal tendencies with opportunities to defraud. It is probably true that, once in the business, such bankers could get more deposits under a guaranty or insurance system than they could otherwise get. But where there are guaranty laws, it is probably harder for such people to get into the banking business now than before the laws were passed; and their opportunities are not sufficiently greater now than before to make it more likely that the opportunities for crime will be availed of.

It is said that insurance of bank deposits will lead to undue expansion, that the affairs of existing banks will be over-extended, and too many new ones organized. It is hard to see how insurance could over-expand existing banks, except by increasing their deposits or by inducing reckless management. As to bad management, we have seen reason to hope that, on the average, it is not more probable with insurance than without. The increase of deposits surely cannot be deplored. At times it does lead to over-expansion of credits, but this is a difficulty inherent in the credit system. As the use of credit increases, because of deposit insurance or any other factor, each expansion of credit is apt to be larger than the one before. We cannot on this account retrace our steps and reject the improvement of credit devices. It is possible that too many new banks will be organized on the adoption of a deposit insurance system. An effort to obtain part of the business of established banks has been suspected in some of the new Oklahoma and Kansas organizations. In some cases the new competition will be beneficial to the public, in others not. In every case, the organizers have supposed that the total deposits of their communities would be more than before. On the economic frontier, at least, it is highly desirable that additional banks be established, because under the American system many remote communities, where the capital necessary to establish independent banks is lacking, have gone without banking facilities altogether. The over-expansion feared is not of a character to lead to great alarm. If the new banks attract sufficient business, they will succeed. If they do not, they will gradually go out of business, or consolidate with other institutions. There is no reason to fear that they will be

the cause of a speculative mania or a general financial crash.

It is said that depositors being by hypothesis satisfied as to the safety of all banks, there would be no reason for any bank to build up a surplus, and the result would be the distribution of all profits, to the weakening of the banking system and its component parts. There is force in the argument. It seems to the writer, however, that surplus is created more to secure stockholders against possible impairment of capital and suspension of dividends than to reassure the depositors. The latter motive, of course, is present, and is a great element of safety. The office of the surplus as a buffer is, however, an important one, and is frequently the chief motive to its accumulation. With a good surplus a bank can sustain, without alarming its stockholders or cutting off their dividends, a loss that, with no surplus or a small one, might not only stop dividends but call for an assessment to repair capital.

Why stop at insuring the deposits of banks? "Why not tax all the manufacturers and merchants to pay the creditors of the unsuccessful or delinquent among them?"[1] But why not regulate the business of manufacturers and merchants as minutely as banks are regulated? Why not limit their borrowings? Why not require them to publish statements, sell only on certain terms and in certain quantities, and submit to inquisitorial visitation? The principle of protecting the creditors of banks is settled. The new method of doing so may be open to criticism, but the principle of safe-guarding depositors is not itself open to debate.

(4) As a further general argument, stress is laid on the

[1] Forgan, loc. cit., p. 29.

unfairness of taxing sound banks to pay the losses of depositors of unsound banks. Tho this consideration would have to give way to the general good if deposit insurance were otherwise desirable, the argument requires examination. The depositors of good banks do not need the insurance. At first thought it seems grossly unjust not only to raise weaker competitors to the same level of safety, but to put the expense of doing this upon the strong banks themselves. This, however, is an argument against all insurance. The honest and careful property owners, through their insurance premiums, pay the fire losses of the careless and incendiary. The strong and healthy pay the death losses of the weak. To make the argument valid, we must go farther, and establish that the deposit insurance will cause so much additional loss as to overbalance the benefits to be derived from it; and this has not been established. In fact, we have concluded that no deposit insurance could be even supposed to make all banks entirely equal in safety. And would deposit insurance be unfair to the strong banks? They would get their returns. The amount of hoarding in this country is enormous. Adequate deposit insurance will increase the deposits of even the most highly esteemed and strongest banks, and so bring them additional revenue.

(5) The next general argument is that such additional revenue would not be nearly enough to sustain the burden of insurance. The average annual loss to depositors in national banks is less than one-twentieth of one per cent., but the insurance premiums for taxes for the guaranty fund would have to be more. The loss experience might increase under the admitted tendency to unwise management, altho this tendency would be in part counteracted by the more fre-

quent examinations and stricter laws that accompany deposit insurance legislation. To the losses would have to be added the expense of management. We have seen that the surety companies have been insuring deposits in a limited way, for one-quarter or one-half of one per cent. Mr. Forgan estimates the present rate of profit on bank deposits, after allowing five per cent. for capital invested, to be three-fourths of one per cent.[1] To insure all of a bank's deposits at one-fourth of one per cent. would take too much of this profit. But if the cost could be reduced to one-tenth of one per cent., it is not so clear that the expense would be too great. Disregarding the profits that would come from additional deposits made on account of insurance, the annual profit on deposits would be reduced from 0.75% to 0.65%. This could be afforded. Or, to calculate the effect on the ratio of profits to capital and surplus, we may note that the profits of the national banks for the year ended July 1, 1909, were 8.72 per cent. of capital and surplus, not much above recent averages. An amount equal to one-tenth of one per cent. of the deposits could be deducted and still leave the profits well above eight per cent. of capital and surplus. The premium or tax of one-tenth of one per cent. is used here more as illustration than estimate. Deposit insurance would bring into play so many tendencies that previous loss experience might prove wholly unreliable.

Averages, however, do not tell the whole effect as to loss-sharing, any more than the averages of loss to depositors tell the whole effect of bank failures. While the averages seemingly indicate that going banks could afford to asume all the losses of depositors in closed banks, the cost to some of the largest, strong-

[1] Loc. cit., p. 15.

est, and most useful banks in the country would be too much. A tax of one-tenth of one per cent. would take $200,000 out of a bank that had $200,000,000 deposits; and it is the large banks in large cities that would derive the least benefit from deposit insurance. Even tho they would gain in deposits, the resulting additional revenue would probably not pay the cost.

A related objection is that the cost of insurance falls upon the bank, and not upon the beneficiary, the depositor; and, as deposits can no more be insured free than can houses, it has been argued that the whole scheme of insurance paid for by the banks is unsound. A great deal of other insurance, however, is paid for by the parties against whose defaults the insurance is written. The employee in many cases pays for the bond that guarantees his own fidelity. The contractor pays for the bond that insures the completion of his work free of mechanics' and material liens. Even banks already buy insurance covering the deposits of public funds. Perhaps the cost of the employee's bond is made up in his pay, perhaps the premium on the contract bond has already been added to the contractor's bid, and perhaps the cost of deposit insurance is eventually paid by the depositor. The fact that the bank pays it is not an objection nor even a novelty.

Of course, deposit insurance premiums must be paid out of the earnings from the deposits, but it is a question whether this means that the cost would fall upon the depositors. Many depositors receive no interest on their deposits. Most of the five thousand millions of individual deposits in national banks bear no interest. The trust companies have shown that in many cases interest on individual deposits

can be afforded. While depositors whose accounts are at interest might find the rate of interest reduced if the accounts were insured, the banks could afford themselves to pay moderate insurance on an enormous total of interest-free accounts.

The insurance of interest-free accounts is not impracticable from the point of view of its effect upon the profits of banks, but may be too expensive for certain banks if compulsory. Like many another reform or improvement of method, it will be well to let deposit insurance introduce itself gradually. This it will do if it can demonstrate its commercial utility. At present its utility in some localities seems likely to exceed its cost, in other localities not. Until the results of current experiments are clear, each bank should be allowed to determine for itself whether or not to procure insurance for its depositors.

(6) A sixth objection to deposit insurance lies against the state-administered kind only, because private insurance corporations could obviate it. This is the objection to the large single risks that must be insured. The objection would apply with considerable force even to compulsory insurance administered from Washington covering all the national banks. The state or nation cannot insure the little banks and decline the big ones. This consideration has been discussed in our study of the Oklahoma situation, and the objection still seems valid. As stated before, if state-administered insurance can be conducted with few or no great losses for a number of years, so that time can be had to accumulate a great reserve, the plan might succeed. But success would be a matter of luck.

(7) The next objection arises in part from the attempt to control the size of risks. It is, in another form,

the objection already mentioned, that state-administered deposit insurance involves too great interference with the conduct of banking. Let the reader refer again to the comparative table of legislation. It will be seen that several of the states are limiting the amount of deposits a bank can receive in proportion to its capital and surplus. Now capital and surplus are the buffers between the investments of a bank and its depositors, and it is commendable that legislators should desire capital and surplus to be adequate. It is submitted, however, that this is not a proper matter for legislative regulation. The great function of commercial banking is to aid commerce and industry by the device of credit, and if a given bank can safely do this to the extent of twenty times its capital and surplus, which it sometimes can (tho not often), why so much the better. So much more capital is left free to other uses.

Again, interest on deposits is limited by the new legislation, for fear some banks will over-expand by paying too much interest, will fail, and involve others in their loss. Some bankers of the older generation do not believe in interest on deposits at all. American banking has been hap-hazard in this regard. The $500 account has had the same treatment as one of $10,000. Gradually, however, it is becoming recognized that some accounts are worth more than the stationery and book-keeping furnished; and bankers must be left free to say what deposits are worth and what they will pay. Unwisdom in paying too much brings its own penalty. A private insurance corporation can say to a bank in eastern Kansas, "in view of the richness of your community and the low rates obtainable on loans, it is unwise for you to pay four per cent. on your deposits, and if you do we

cannot insure them." At the same time the company may be glad to see one of its risks in western Kansas increasing its business by paying four per cent. This is the beneficial "higgling of the market," while the fixing of the price of deposits by legislation would impair enterprise and interfere in some degree with economic development.

The other social objection, that it is not wise to exempt individuals from the consequences of their mistakes, has no weight, because it is in so many cases not applicable to the selection of a depositary. The presumption is always in favor of the bank under consideration, because the state or nation is allowing it to run. General reputation is usually the only guide for the intending depositor. He must deposit somewhere, or ought to, and no social purpose is served by putting upon him the consequences of a mistake he had no means of avoiding.

The immediate future of deposit insurance depends much upon the result of pending litigation. If the guaranty laws are upheld, the state guaranty systems will be used for a time. It may be that in spite of the large single risks, and the tendency to unwise liberality in bank management, the state guaranty funds will grow large enough to assure the success of the experiments. In that case, some national banks will probably begin to insure their depositors. If the laws are held unconstitutional, there will probably be a good deal of insurance of deposits in private companies on account of banks in Oklahoma and perhaps elsewhere. The deposits of Oklahoma banks increased so rapidly under state insurance that they are not likely to discontinue insurance altogether if they can find companies to write it.

The laws will all need amendment. The Oklahoma fund is not accumulated rapidly enough and the Kansas fund is too small. Kansas does not insure the deposits made by banks, altho these should be insured as much as any, because they are the reserve of the depositing banks and much depends on such deposits. Oklahoma must abandon the effort to pay depositors as soon as a bank is closed. This is not the place, however, for proposals of legislative changes.

In the end, we come back to the question of the need of the insurance. Hoarding and distrust of banks are found to some extent everywhere in this country. Deposit insurance would call out most of the hoards and remove most of the distrust. Oklahomans are typical Americans, and they swelled the deposits of their banks as soon as the deposits were insured; while large amounts of deposits came from Americans in other states.

This has been a remarkable economic experiment, projected in time of panic, taken up as a national political issue, and carried on under the fire of hostile litigation. If successful, it would serve high social purposes, and the objections to the state control involved might be waived if they did not interfere with success, and if there were no better way to achieve the great purposes in view. Politics can be eliminated. Compulsory, state-administered insurance of deposits has not been proved impracticable, altho the resulting tendency to uncareful management, the expense and perhaps unfairness to sound banks, and the impossibility of selecting the risks must cause misgiving. These objections almost all disappear in the consideration of insurance by private corporations. Such insurance may prove the ultimate solution of the problem.

It must not be thought, however, that the introduction of private insurance, as distinguished from that administered by the state, will be rapid. It will be slow. The benefit to many banks would be small, and others will take it up most gradually. Bankers are the most conservative of men. They know that their banks are good, and many will feel insulted when solicited to insure their depositors against loss. But, if the limited observations here set down are valid over a wide area, and the writer believes they are, it will gradually and beneficially become the custom to insure bank deposits.

THORNTON COOKE.

FIDELITY TRUST COMPANY,
KANSAS CITY, MO.

## APPENDIX — CERTAIN ITEMS IN RECENT BANK STATEMENTS[1]

| | OKLAHOMA[2] | KANSAS | TEXAS | SOUTH DAKOTA[2] | NEBRASKA[2] |
|---|---|---|---|---|---|
| STATE BANKS | Nov. 16, '09 | Sept. 29, '09 | Nov. 16, '09 | Nov. 16, '09 | Nov. 16, '09 |
| Number of banks | 662 | State 812<br>Private 4<br>Trust Co. 3<br>Total 819 | State 450<br>Trust Co. 52<br>Total 502 | 474 | 662 |
| Capital | 10,767,800 | 15,810,800 | 16,114,000 | 6,316,275 | 12,027,240 |
| Surplus | 881,340 | 4,957,936 | 1,475,960 | 972,942 | 2,115,977 |
| Due to banks | 4,537,080 | 97,217,510 | 6,541,580 | 2,590,551 | 73,283,626 |
| Individual deposits | 49,775,433 | | 43,328,797 | 49,557,408 | |
| Due from banks | 20,659,289 | 36,528,127 | 18,051,023 | 14,497,871 | 15,075,686 |
| Cash in bank | 4,607,348 | | 5,324,673 | 2,722,583 | 4,452,424 |
| NATIONAL BANKS | Nov. 16, '09 | Nov. 16, '09 | Nov. 16, '09 | Nov. 16, '09 | Nov. 16, '09 |
| Number of banks | 220 | 206 | 519 | 95 | 220 |
| Capital | 10,070,000 | 11,992,500 | 42,393,300 | 3,740,000 | 14,395,000 |
| Surplus | 2,674,142 | 4,887,573 | 19,551,996 | 747,450 | 5,600,960 |
| Due to banks | 8,263,308 | 16,691,222 | 38,744,096 | 5,295,688 | 28,948,348 |
| Individual deposits | 41,617,229 | 67,094,340 | 164,618,078 | 28,631,498 | 82,784,953 |
| U. S. deposits | 765,831 | 651,519 | 1,137,333 | 545,459 | 1,044,760 |
| Due from banks | 16,657,396 | 21,179,768 | 59,693,840 | 8,238,287 | 25,551,358 |
| Cash in bank | 4,968,818 | 7,780,867 | 22,314,188 | 2,747,068 | 10,615,642 |

[1] The banking departments of the different states do not compile their reports in quite the same way, and the amounts given above as "due from banks" and as "individual deposits" do not in all cases include quite the same items. The differences, however, are immaterial.

[2] All banks other than national.